

JAN 23 2007

FEDERAL ELECTION COMMISSION

999 E Street, N.W.
Washington, D.C. 20463

SENSITIVE

FIRST GENERAL COUNSEL'S REPORT

AUDIT REFERRAL: 06-04

DATE REFERRED: October 12, 2006

DATE ACTIVATED: October 31, 2006

STATUTE OF LIMITATIONS: March 31, 2009/March 7, 2010¹

SOURCE: AUDIT REFERRAL

RESPONDENTS: Washington State Democratic Central Committee and Habib M. Habib, in his official capacity as Treasurer

**RELEVANT STATUTES
AND REGULATIONS:**

2 U.S.C. § 432(c)(5)
2 U.S.C. § 432(b)(3)
2 U.S.C. § 434(b)
2 U.S.C. § 438(b)
11 C.F.R. § 104.3(b)

INTERNAL REPORTS CHECKED: Disclosure Reports

FEDERAL AGENCIES CHECKED: None

I. INTRODUCTION

This matter was generated by a Commission audit, pursuant to 2 U.S.C. § 438(b), of the Washington State Democratic Central Committee ("WSDCC" or "the Committee") and involves the alleged embezzlement of funds from the Committee by one of its employees, Ryan Pennington. As required by the Commission's new referral policy for matters involving apparent embezzlement, the Audit Division referred this matter to us upon discovering the potential embezzlement. As

¹ The statute of limitations as to Mr. Pennington is March 31, 2009, and the statute of limitations as to the Washington State Democratic Central Committee and Habib M. Habib, in his official capacity as treasurer, is March 7, 2010.

11044293089

2007 JAN 23 A 10:04
SECRET JAN 23

1 such, the audit of WSDCC is still in progress, and the Preliminary Audit Report is not expected to
2 be completed until approximately April 2007. As more fully set forth below, we recommend that
3 the Commission (1) generate Ryan Pennington as a respondent and find reason to believe that he
4 knowingly and willfully violated 2 U.S.C. § 432(b)(3) by commingling campaign funds with
5 personal funds and (2) take no action at this time as to whether the Washington State Democratic
6 Central Committee and Habib M. Habib, in his official capacity as treasurer, violated 2 U.S.C.
7 § 434(b) by failing to timely disclose expenditures.

8 **II. FACTUAL SUMMARY**

9 The WSDCC is a qualified party committee that is registered with the Commission. During
10 the Committee's annual audit in the beginning of 2005, it discovered accounting irregularities that
11 it eventually determined were the result of fraudulent invoicing by Stack of Dimes, one of its media
12 vendors. Specifically, during the 2004 election cycle, Stack of Dimes invoiced the Committee for
13 approximately \$65,000 in services, even though the actual value of the services is reportedly far
14 less.² The Committee appears to have paid the invoices in four separate transactions and reported
15 those disbursements as allocable expenditures.³

Report	Date of Disbursement	Date Report Filed	Page	Total
2004 April Monthly	03/31/04	04/21/04	58	\$17,321.22
2004 12 Day Pre-General	10/01/04	11/11/04	67	\$9,953.26
2004 30 Day Post-General	10/30/04	12/03/04	289	\$17,996.75
2004 30 Day Post-General	11/09/04	03/07/05	324	\$20,000.00
Total:				\$65,271.23

² Available information does not indicate the actual value of the services. In one news account, Paul Berendt, chairman of the Washington State Democratic Party, allegedly stated that the value of the services was \$10,000. However, this is not substantiated by any other statements or reports. Josh Feit, *Glass Houses*, THE STRANGER, available at <http://www.thestranger.com/seattle/Content?oid=25509> (last visited January 8, 2007).

³ There was also a \$500 disbursement to Stack of Dimes on November 21, 2003. However, this disbursement does not appear to be part of the fraudulent invoicing scheme and appears to have been timely disclosed.

11044293090

11044293091

Stack of Dimes appears to have been a legitimate vendor of, and did in fact provide services to, the Committee. The Committee claims that its internal controls policies require two signatories and that the checks to Stack of Dimes were, in fact, signed by two employees. There is no information indicating the extent of this policy or whether it was in writing. All four checks appear to have been signed by Mr. Pennington, the Committee's Coordinated Campaign Manager, and an unidentified Committee employee. According to disclosure reports filed by the Committee and information provided by the Committee to the Reports Analysis Division ("RAD"), Mr. Pennington and this unidentified employee had partnership interests in Stack of Dimes, and Mr. Pennington was responsible for the inflated invoices to the Committee. There is no information that the other employee knew the invoices were inflated, and, according to the Committee, its internal investigation indicates that the other employee "apparently knew nothing about the fraudulent invoices." WSDCC, Miscellaneous Report to FEC, March 27, 2006. A news article written in December 2005 reports that the Committee claims it did not know, at the time of the disbursements, that Mr. Pennington had an interest in Stack of Dimes.⁴

The Committee appears to have first notified the Commission of a potential problem involving embezzlement on June 8, 2005. Neil Reiff, a representative of the Committee, stated to RAD that "he wasn't comfortable reporting [the activity] as 'theft' when it hadn't been proven or [when the Committee was] investigating the issue [because] he didn't want to accuse someone on the public record." RAD Communication Log of Jodi Winship (July 8, 2005). On March 27, 2006, the Committee filed a Miscellaneous Report that clarified the results of its investigation, stating that "the Coordinated Campaign Manager embezzled funds from the [Committee] by having a vendor,

⁴ Josh Feit, *Glass Houses*, THE STRANGER, available at <http://www.thestranger.com/seattle/Content?oid=25509> (last visited January 8, 2007).

1 Stack of Dimes, . . . bill the WSDCC for computer services never received After the
2 embezzlement was discovered and charges filed, the WSDCC agreed to drop the charges if the
3 funds were returned." WSDCC, Miscellaneous Report to FEC, March 27, 2006. Although the
4 Committee declined to name the suspected embezzler, it appears it was Mr. Pennington.⁵

5 On July 20, 2005, the Committee filed its 2005 July Monthly Report, in which it disclosed
6 two reimbursements for a total of \$60,000 received on June 28, 2005. The following table lists all
7 reimbursements to the Committee for the embezzled money:

From	Page	Total
Stack of Dimes	48	\$50,000.00
Saunders, on behalf of Stack of Dimes – Jill Schwarzmiller	48	\$10,000.00
Total:		\$60,000.00

8 In an amended report filed October 12, 2005, the Committee clarified that the
9 reimbursements were refunds from Stack of Dimes for the overpayments.⁶

10 III. LEGAL ANALYSIS

11 A. WSDCC

12 Under the Act, a committee, through its treasurer, is responsible for accurately accounting
13 for receipts and disbursements and for correctly reporting both to the Commission. See 2 U.S.C.
14 §§ 432(c)(5) and 434(b)(4); 11 C.F.R. § 104.3(b). In other enforcement matters, the Commission
15 found reason to believe that committees violated 2 U.S.C. § 434(b) for reporting errors caused by

⁵ A journalist reported that Mr. Pennington was the embezzler. Josh Feit, *Glass Houses*, THE STRANGER, available at <http://www.thestranger.com/seattle/Content?oid=25509> (last visited January 8, 2007). Also, the Committee refers to the embezzler in a public statement filed with the Commission as its "Coordinated Campaign Manager," and Mr. Pennington appears to have been a Coordinated Campaign Manager for WSDCC in 2005. See Committee Response, March 27, 2006; 2004 Presidential Campaign by Democracy In Action, available at <http://www.gwu.edu/~action/2004/states/wadet04.htm> (last visited January 8, 2007).

⁶ In its amended 2005 July Monthly report, the Committee provided the following explanation for these reimbursements: "The refund of previously allocated allocable expenses totaling \$60,000 were originally reported as follows: 3/30/04 Stack of Dimes \$17,321.22; 10/01/04 Stack of Dimes \$9,953.26; 10/30/04 Stack of Dimes \$17,996.75; 11/09/04 Stack of Dimes \$20,000."

11044293092

1 embezzlement where the committees apparently failed to implement adequate internal controls.

2 *See, e.g.*, MURs 5721 (Lockheed Martin PAC), 5811 (Doggett for Congress), 5812 (Ohio State
3 Medical Association PAC), and 5813 (Georgia Medical PAC).

4 In this matter, the Committee appears to have paid for and timely reported as expenditures
5 the first three of the four disbursements to Stack of Dimes listed in the chart above. *See, supra*,
6 Section II, at 2. Thus, it does not appear to have violated the Act with respect to these transactions.
7 The fourth expenditure to Stack of Dimes, however, for \$20,000 on November 9, 2004, was
8 reported four months after the reported date of the transaction. While this would appear to be a
9 violation of 2 U.S.C. § 434(b), available information does not indicate the extent to which the late
10 reporting of the \$20,000 transaction was caused by the embezzlement scheme, as opposed to being
11 the result of an unrelated reporting oversight.

12 In contrast to previous matters where the embezzlers concealed the misappropriation of
13 funds from the committees, and the committees found out about, and subsequently disclosed, the
14 disbursements after the reporting deadline, the transactions containing the misappropriations appear
15 to have been the result of invoices that were legitimately submitted to the Committee, although for
16 inflated amounts. Thus, the embezzlement scheme in this matter did not rely on concealing
17 transactions in their entirety, but, instead, relied on fraudulently representing the amount of each
18 transaction. The fact that the other three disbursements were reported timely suggests that the
19 failure to disclose the \$20,000 disbursement may not have been the result of the embezzlement
20 scheme.

21 Moreover, there is little information indicating what, if any, internal controls the Committee
22 had in place. On October 20, 2006, following a dramatic increase in the number of cases involving
23 misappropriation of committee funds by a committee employee, the Commission requested public

11044293093

1 comment on a proposed policy that would provide a "safe harbor" for committees that implement
2 an enumerated list of internal controls and take specific corrective actions upon discovering the
3 misappropriation. FEC Proposed Embezzlement Policy (October 20, 2006). The list of controls
4 includes, among others, maintaining a bank account only in the name of the Committee, requiring
5 two signatures on checks over \$1,000, and requiring someone other than the check signor to
6 reconcile accounting records and receipts each month.⁷ The only information currently available
7 regarding the Committee's internal controls is that the Committee states it required two signatures
8 on checks.

9 An investigation would be warranted to determine (1) whether the late reporting of the
10 \$20,000 transaction was caused by the embezzlement scheme or was simply the result of an
11 unrelated reporting oversight and (2), if caused by the embezzlement scheme, the extent of the
12 internal controls maintained by the Committee. However, investigating this apparent violation at
13 this time might not be an efficient use of the Commission's resources, because the Commission is
14 currently conducting a 2 U.S.C. § 438(b) audit of WSDCC. Because an investigation of the
15 Committee by this Office would likely be duplicative, we believe any further enforcement action as

⁷ Because the apparent embezzlement scheme employed in this matter is unique, as discussed above, it is not clear that the Committee would have been able to prevent or detect the misappropriation, even if it had implemented and followed every internal control in the proposed policy. First, because the misappropriated disbursements appear to have been made to a legitimate vendor, maintaining the bank accounts in the name of the Committee, as opposed to an individual, would not have made a difference in preventing or detecting this scheme. Second, information from the Committee indicates that it required two signatures for each of the misappropriated disbursements and that the two signatories were authorized by the Committee. While we do not know if Mr. Pennington and the other employee were identified in writing as being authorized signatories, as would be required by the proposed policy, this would have no impact on the type of embezzlement scheme at issue in this matter, because the misappropriation was not caused by unauthorized employees signing checks; it was caused by the employees having a financial interest in the payee. Although it is a concern that the signatories apparently had a conflict of interest due to being partners in Stack of Dinres, the proposed policy, at least on its face, does not preclude an individual with such an interest from being a signatory. Third, having a separate individual receive and inventory receipts would not have identified this embezzlement scheme, as it did not involve disbursements made to the Committee. Fourth, because information indicates that Stack of Dinres was a legitimate vendor and properly invoiced the Committee, albeit for an inflated amount, the bank statements would reconcile with the accounting records. Thus, this control would not have prevented or discovered the embezzlement scheme. Fifth, it does not appear that any funds were misappropriated from petty cash.

11044293094

1 to the Committee should occur as the result of a referral in the normal course of the ongoing audit.
2 Accordingly, we recommend that the Commission take no action at this time as to the Washington
3 State Democratic Central Committee and Habib M. Habib, in his official capacity as treasurer.

4 **B. Ryan Pennington**

5 The Act prohibits the commingling of committee funds with "the personal funds of any
6 individual." 2 U.S.C. § 432(b)(3). Although available information does not indicate how Mr.
7 Pennington commingled WSDCC's campaign funds with personal funds, there is a sufficient basis
8 to investigate to determine whether he endorsed the campaign funds to himself and deposited them
9 directly into a personal account, or whether the campaign funds were commingled after being
10 deposited in the Stack of Dimes account. Therefore, we recommend that the Commission generate
11 Ryan Pennington as a respondent and find reason to believe that he knowingly and willfully
12 commingled Committee funds with the personal funds of an individual in violation of 2 U.S.C.
13 § 432(b)(3).⁸ See, e.g., MUR 5813 (Georgia Medical PAC) and MUR 5811 (Doggett for U.S.
14 Congress) (in both matters, the Commission found that commingling funds in embezzlement
15 schemes in which the misappropriation of funds is hidden constitutes knowing and willful
16 behavior).

17
18
19
20
21

⁸ Because, as discussed *supra*, it is not clear that the embezzlement scheme resulted in any misreporting to the Commission, and Mr. Pennington was never the treasurer of the Committee, we make no recommendations as to Mr. Pennington regarding potential reporting violations.

V. RECOMMENDATIONS

1. Open a MUR in AR 06-04;
2. Find reason to believe that Ryan Pennington knowingly and willfully violated 2 U.S.C. § 432(b)(3), and approve the attached Factual and Legal Analysis;
3. Take no action at this time regarding whether the Washington State Democratic Central Committee and Habib M. Habib, in his official capacity as treasurer, violated 2 U.S.C. § 434(b) by failing to timely disclose expenditures;
4. Authorize the use of compulsory process;
5. Approve the appropriate letters.

Lawrence H. Norton
Counsel

Lawrence L. Calvert, Jr.
Deputy Associate General Counsel

Date: 1/23/07

By:


Ann Marie Terzaken
Assistant General Counsel


Zachary Mahshie
Attorney

11044293096